DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 06-0416
Sales and Use Tax
For the Years 2003, 2004, 2005

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales and Use Tax – Imposition of Tax.

Authority: IC § 6-2.5-1-21; IC § 6-2.5-2-1; IC § 6-2.5-3; IC § 6-2.5-4-1; IC § 6-8.1-5-1; IC § 8.1-5-4; 45 IAC 2.2-4-26; 45 IAC 2.2-4-27; *Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Black's Law Dictionary (8th ed. 2004).

Taxpayer protests the imposition of use tax on tangible personal property.

II. Tax Administration – Penalty.

Authority: IC § 6-8.1-10.2.1; 45 IAC 15-11-2.

Taxpayer protests the proposed assessment of the ten percent negligence penalty.

STATEMENT OF FACTS

The taxpayer is a design firm which designs buildings for general public use. In Illinois and Indiana it oversees the construction of the buildings which they design, and where they act in the capacity of a general contractor.

The Indiana Department of Revenue ("Department") conducted an audit which determined that the taxpayer owed use tax on various transactions. The taxpayer conceded that some of the items were rightfully assessed, but protests the assessments on others. The taxpayer also protests the ten percent negligence penalty assessed by the Department.

The Department held a hearing to offer the taxpayer the opportunity to present its protest. The hearing was held open for an additional two weeks to allow the taxpayer to further substantiate its protest. This Letter of Findings results. Additional facts will be presented as necessary.

I. Sales and Use Tax – Imposition of Tax.

DISCUSSION

In accordance with IC § 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on Indiana retail transactions unless a valid exemption is applicable. IC § 6-2.5-4-1 provides that a retail transaction involves the transfer of tangible personal property. Indiana imposes a use tax on tangible personal property stored, used, or consumed in Indiana when no sales tax was paid at the time of purchase. IC § 6-2.5-3-2. All tax assessments are presumed to be accurate, and the taxpayer bears the burden of proving that an assessment is incorrect. IC § 6-8.1-5-1(b), (c); *Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

A. Lump Sum Contracts.

The taxpayer argues that numerous invoices that it paid were for time and materials even though the invoices only showed a total amount owed, a form of invoice otherwise known as a lump sum contract. The taxpayer concedes that it did not pay sales tax for any materials that may be included in the invoices. However, the taxpayer argues that it should only be assessed use tax for the amounts contained within the lump sums that were actually for materials.

45 IAC 2.2-4-26 states:

> (a) A person making a contract for the improvement to real estate whereby the material becoming a part of the improvement and the labor are quoted as one price is liable for the payment of sales tax on the purchase price of all material so used.
> (b) A person selling tangible personal property to be used as an improvement to real estate may enter into a completely [sic.] separate contract to furnish the labor to install or construct such improvement, in which case the sales tax shall be collected and remitted by such seller on the materials sold for this purpose. Such sales of materials must be identifiable as a separate transaction from the contract for labor. The fact that the seller subsequently furnished information regarding the charges for labor and material used under a flat bid quotation shall not be considered to constitute separate transactions for labor and material.

For the invoices in question, the taxpayer does not know how much of the invoice price is for material and how much is for labor, as these components are not broken out on the invoice. At the time of the taxpayer's hearing with the Department, the taxpayer

mentioned it would attempt to gain additional information from some of its sub-contractors to determine a breakout of labor and materials. However, subsequent to the hearing, the taxpayer did not provide any additional information to show amounts that could be attributed to materials on the invoices in question.

The taxpayer's protest on the assessment of use tax on these lump sum contracts is respectfully denied.

B. Tax Exempt Organization.

The taxpayer argues that certain invoices contained amounts for materials that became part of realty that is leased by a hospital. Thus the taxpayer contends that use tax should not be assessed for materials that became part of space used by the hospital which is a tax exempt entity.

45 IAC 2.2-4-26(c) states:

> Tangible personal property purchased to become a part of an improvement to real estate under a contract with an organization entitled to exemption is eligible for exemption when purchased by the contractor.

The taxpayer acted as general contractor on a mixed-use building owned by a for-profit company. One tenant of the building was a tax-exempt hospital that leases about twenty-five percent of the building. Even though under the contract the taxpayer had to install specific-use cabinets and doors to meet the needs of the tenant/hospital, the hospital was not a party to the contract. The contract in question was with the non-exempt building owner, not the exempt hospital. The building owner was therefore not entitled to the exemption.

The taxpayer's protest on the assessment of use tax on materials incorporated into realty that was leased to a not for profit is respectfully denied.

C. Rental Property.

Two invoices in question were for the installation of a construction fence to protect the job site. The fence company installed the fence at the beginning of the construction project and removed the fence at the end of the project. The taxpayer states that it did not ever own the materials which were used in the fencing because the materials were returned to the fencing company at the end of the construction project. The auditor agreed with this, but subjected the contract to use tax because it was a rental contract.

The taxpayer argued that their invoices did not reflect rental contracts as claimed by the auditor. At the hearing the taxpayer stated that the contract should not be considered a rental contract because it did not require periodic payments and it did not have a specific term.

45 IAC 2.2-4-27 states:

> (a) In general, the gross receipts from renting or leasing tangible personal property are taxable. This regulation [45 IAC 2.2] only exempts from tax those transactions which would have been exempt in an equivalent sales transaction.
> (b) Every person engaged in the business of the rental or leasing of tangible personal property, other than a public utility, shall be deemed to be a retail merchant in respect thereto and such rental or leasing transaction shall constitute a retail transaction subject to the state gross retail tax on the amount of the actual receipts from such rental or leasing.
> (c) In general, the gross receipts from renting or leasing tangible personal property are subject to tax. The rental or leasing of tangible personal property constitutes a retail transaction, and every lessor is a retail merchant with respect to such transactions. The lessor must collect and remit the gross retail tax or use tax on the amount of actual receipts as agent for the state of Indiana. The tax is borne by the lessee, except when the lessee is otherwise exempt from taxation.
> (d) The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

IC § 6-2.5-1-21, defining "lease" or "rental," was added to the Indiana Code as a new section in 2003, effective January 1, 2004, and applies to leases or rentals entered into after June 30, 2003:

> (a) "Lease" or "rental" means any transfer of possession or control of tangible personal property for a fixed *or indeterminate term* for consideration and may include future options to purchase or extend. "Lease" or "rental" does not include:
> (1) a transfer of possession or control of property under a security agreement or deferred payment plan that requires the transfer of title upon completion of the required payments;
> (2) a transfer of possession or control of property under an agreement that requires the transfer of title upon completion of required payments and payment of an option price that does not exceed the greater of one hundred dollars ($100) or one percent (1%) of the total required payments; or
> (3) providing tangible personal property along with an operator for a fixed or indeterminate period, if:
> (A) the operator is necessary for the equipment to perform as designed; and
> (B) the operator does more than maintain, inspect, or set up the tangible personal property.

> (b) "Lease" or "rental" includes agreements covering motor vehicles and trailers in which the amount of consideration may be increased or decreased by reference to the amount realized upon sale or disposition of the property as defined in 26 U.S.C. 7701(h)(1).
> (c) The definition of "lease" or "rental" set forth in this section applies throughout this article, regardless of whether a transaction is characterized as a lease or rental under generally accepted accounting principles, the Internal Revenue Code, the uniform commercial code (IC 26-1), or other provisions of federal, state, or local law.
> (d) This section applies only to leases or rentals entered into after June 30, 2003, and has no retroactive effect on leases or rentals entered into before July 1, 2003. (*Emphasis added*).

The taxpayer's contracts for the fencing, as evidenced by the invoices, were dated May 16, 2003, and April 14, 2005. The latter clearly falls within IC § 6-2.5-1-21(a)'s definition of a rental contract "for a fixed or indeterminate term."

Furthermore, Black's Law Dictionary 907, 1322 (8th ed. 2004) provides these definitions for rent and lease:

> **Rent.** Consideration paid, usu. periodically for the use or occupancy of property.
>
> **Lease.** A contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration. The lease term can be for life, for a fixed period, or for a period terminable at will.

Black's Law Dictionary indicates that rent is any consideration paid for the use of property. The definition of rent indicates that the consideration is *usually* paid periodically, which, by implication means that periodic payments are not always required. Also, the lease term can be terminable at will (or at the end of a construction project). In addition, in an addendum to one of the invoices in question the fence company uses the term "rent." The fence company indicates in this document that there is no time limit for the taxpayer's use of the fence, and that there will be "no additional rent." So, the May 16, 2003, contract also falls within the common understanding of the terms of a lease contract.

The fence contract is a rental agreement, and 45 IAC 2.2-4-27 states that gross receipts from renting tangible personal property are subject to sales tax. Since the fencing company did not pay Indiana sales tax on the receipts from the rental agreement, the taxpayer is subject to use tax.

The taxpayer's protest on the assessment of use tax on its fencing contract is respectfully denied.

D. Lost Invoices.

The taxpayer argues that the auditor lost several of taxpayer's invoices, so that at the time of the hearing the taxpayer did not have the records to substantiate various claims. IC § 6-8.1-5-4 states:

> Sec. 4. (a) Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.

Regardless of who lost the records that would substantiate the taxpayer's claim, the taxpayer has the burden to replace the records even if that means asking its vendors to provide duplicate copies of invoices.

FINDINGS

Taxpayer's protest as to imposition of use tax is respectfully denied for all subparts above.

II. Tax Administration – Penalty.

DISCUSSION

The taxpayer protests the imposition of the ten percent negligence penalty pursuant to IC § 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2(b) clarifies the standard for the imposition of the negligence penalty as follows:

> Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

Additionally 45 IAC 15-11-2(c) states:

> The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay

> a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:
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> (1) the nature of the tax involved;
> (2) judicial precedents set by Indiana courts;
> (3) judicial precedents established in jurisdictions outside Indiana;
> (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
> (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and, thus, will be dealt with according to the particular facts and circumstances of each case. Taxpayer has established to the Department's satisfaction that he exercised ordinary business care and prudence. Therefore, the Department waives the penalty.

FINDING

Taxpayer's protest as to the imposition of penalty is sustained.

PLG/LS/WL/DK – December 31, 2007